

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Hurley Medical Center	County Genesee
Audit Date 6/30/05	Opinion Date 10/7/05	Date Accountant Report Submitted to State:	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) Plante & Moran, PLLC			
Street Address 111 E. Court Street, Suite 1A	City Flint	State MI	ZIP 48502
Accountant Signature <i>Todd Harkness</i> ET		Date 11-17-05	

Financial Statements
Hurley Medical Center
Flint, Michigan
June 30, 2005 and 2004

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Independent Auditor's Report

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

We have audited the accompanying financial statements of the business-type activities of Hurley Medical Center (a component unit of the City of Flint, Michigan) as of June 30, 2005, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Hurley Medical Center as of June 30, 2004 were audited by BKR Dupuis & Ryden, who merged with Plante & Moran, PLLC, as of July 1, 2005, whose report dated October 1, 2004 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2005 financial statements referred to above present fairly, in all material respects, the financial position of Hurley Medical Center as of June 30, 2005, and the results of its operations, changes in its fund net assets, and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PLANTE & MORAN, PLLC

October 7, 2005

Hurley Medical Center

Management's Discussion and Analysis

GASB No. 34

Hurley Medical Center, as a component unit of the City of Flint, Michigan, has implemented the new Governmental Accounting Standards Board Statement No. 34. As required by GASB No. 34, Hurley Medical Center includes Management's Discussion and Analysis in the annual audit report. This section presents our discussion and analysis of Hurley Medical Center's financial performance during the fiscal year ended June 30, 2005. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the management's discussion and analysis.

Description of Organization

Hurley Medical Center is a 463 bed teaching hospital. It is the sole provider in the region for Level I Trauma services, neonatal intensive care unit, burn unit, pediatric intensive care unit, involuntary mental health unit, and kidney transplant services. Additionally, Hurley has large programs in Obstetrics, Pediatrics, Oncology, Cardiology, and Surgery. As a teaching hospital, Hurley trains over 90 residents annually from both the Michigan State University and University of Michigan Medical Schools. Additionally, Hurley has a joint nursing school with the University of Michigan and several paraprofessional training schools. With over 2,400 employees, Hurley is one of the largest employers in the region.

Financial Statements

This report consists of four parts – Management's Discussion and Analysis (this section), the basic financial statements, required supplemental information, and an optional section that presents consolidating financial statements.

Included in this report are the following financial statements for Hurley Medical Center and its wholly owned subsidiary and component unit, Hurley Health Services:

1. Balance Sheets
2. Statements of Revenues, Expenses, and Changes in Fund Net Assets
3. Statements of Cash Flows

These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center but restricted for specific purpose by contributors, grantors, or enabling legislation.

Condensed Financial Information (Primary Government- Hurley Medical Center)

	<u>(In Thousands)</u>	
	<u>6/30/05</u>	<u>6/30/04</u>
Non-capital assets	\$177,881	\$175,129
Capital assets – net	<u>59,272</u>	<u>60,209</u>
Total assets	<u>\$237,153</u>	<u>\$235,338</u>

Condensed Financial Information – (continued)

	<u>(In Thousands)</u>	
	<u>6/30/05</u>	<u>6/30/04</u>
Current liabilities	\$ 45,723	\$ 51,041
Long-term liabilities	96,492	89,824
Total liabilities	<u>\$142,215</u>	<u>\$140,865</u>
Invested in capital assets, net of related debt	\$ 1,838	\$ (604)
Unrestricted	89,971	91,970
Restricted	3,129	3,107
Total net assets	<u>\$ 94,938</u>	<u>\$ 94,473</u>

Current assets, capital assets and net assets all remained relatively constant between 2004 and 2005 with net assets increasing approximately \$465,000 or 0.4%.

	<u>(In Thousands)</u>	
	<u>6/30/05</u>	<u>6/30/04</u>
Operating revenue	\$277,628	\$260,872
Net patient service revenue - other	24,217	26,402
Total operating revenues	301,845	287,274
Operating expense:		
Salaries and wages	126,072	122,217
Professional services	30,523	31,381
Payroll taxes/fringes	46,699	33,445
Supplies	35,502	36,215
Purchased services	50,995	44,812
Depreciation/amortization	10,227	11,056
Operating expenses	<u>300,018</u>	<u>279,126</u>
Operating income	1,827	8,148
Non-operating revenues (expenses) and other	<u>(1,385)</u>	<u>(4,819)</u>
Excess of revenues over expenses before capital contributed restricted fund activity, and transfer of funds	442	3,329
Net other contributions (expenses)	<u>23</u>	<u>(596)</u>
Changes in net assets	<u>\$ 465</u>	<u>\$ 2,733</u>

Financial Highlights

Hurley Medical Center reported an increase in net operating revenues of 5.1% in fiscal year 2005. Decreased patient volumes, early in the fiscal year, caused significant bottom line deficits; however, patient volumes began exceeding budget in February. After net losses in each of the first 11 months, there was a very strong finish in June, which caused the final net income to be slightly positive. Any profit in 2005 is especially significant because the pension funding of \$9 million resumed in 2005, after several years without pension expense due to the plan being overfunded.

On July 1, 2004, Hurley Medical Center entered into an interest rate swap agreement related to the 2003 bond issue of \$35 million. The impact of the agreement changed interest to be paid from a fixed rate of 5.69% to a variable rate of 3.3%. The term of the agreement is seven years but can be terminated at any time.

During 2005, Hurley Medical Center signed three year agreements with all nine of its collective bargaining units. The agreements are effective from July 1, 2004 through June 30, 2007.

Change in Management Personnel

President and CEO Mr. Julius Spears resigned in December 2004, to assume the presidency of a hospital in Washington D.C. After a national search, Mr. Patrick Wardell was hired as Hurley's new President and CEO. Mr. Wardell has extensive experience in healthcare, most recently serving as the senior vice president for the Brooklyn/Queens region of the St. Vincent Catholic Medical Centers of New York City. Prior to his work with the St. Vincent system, Mr. Wardell was Present and CEO of St. Joseph's Regional Medical Center in Paterson, New Jersey. Mr. Wardell assumed his new role in August 2005.

Significant Transactions

There were no significant transactions during fiscal 2004.

Capital Assets

During fiscal 2005, Hurley Medical Center purchased \$9.4 million of capital assets which consisted of various improvements to the infrastructure, information technology and equipment. No item was deemed to be individually significant.

Long-Term Debt

No new debt was issued during fiscal year 2005 and \$3.1 million of principal was paid on outstanding debt.

**Hurley Medical Center
Balance Sheets
June 30, 2005 and 2004**

	2005		2004	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Assets				
Current assets:				
Cash and cash equivalents	\$ 21,463,737	\$ 2,453,682	\$ 30,010,343	\$ 3,148,097
Patient accounts receivable, net (Note 4)	69,192,051	326,661	55,855,414	447,549
Other receivables	4,862,197	566,568	7,302,034	598,363
Inventories	3,545,637	40,081	3,222,448	-
Prepaid expenses and other	2,247,145	1,341,537	2,253,879	876,380
Assets limited as to use (Note 5)	4,319,753	326,912	3,153,535	-
Total current assets	105,630,520	5,055,441	101,797,653	5,070,389
Assets limited as to use (Note 5):				
By the Board	49,911,728	326,912	45,206,388	-
Under bond indenture agreement - held by trustee	12,363,497	-	17,342,320	-
Restricted	369,340	-	330,589	-
Total assets limited as to use	62,644,565	326,912	62,879,297	-
Less assets limited as to use that are required for current liabilities	(4,319,753)	(326,912)	(3,153,535)	-
Noncurrent assets whose use is limited	58,324,812	-	59,725,762	-
Other assets:				
Defeasance loss, net	1,022,042	-	1,169,612	-
Bond issuance costs, net	700,810	-	773,391	-
Investment in joint ventures (Note 14)	5,366,269	1,579,367	4,496,452	1,764,536
Investment in Hurley Health Services	6,836,176	-	7,165,475	-
Other	-	59,430	-	182,264
Total other assets	13,925,297	1,638,797	13,604,930	1,946,800
Capital assets, net (Note 17)	59,271,985	1,557,032	60,209,355	1,670,841
	<u>\$ 237,152,614</u>	<u>\$ 8,251,270</u>	<u>\$ 235,337,700</u>	<u>\$ 8,688,030</u>

See notes to financial statements.

Liabilities and Fund Net Assets	2005		2004	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Current liabilities:				
Accounts payable and taxes withheld	\$ 14,663,217	\$ 135,371	\$ 14,711,125	\$ 365,162
Current portion of long-term debt and lease obligations (Notes 6 and 7)	3,630,789	-	3,407,320	-
Accrued expenses	20,737,316	1,279,723	26,361,032	1,157,393
Total current liabilities	39,031,322	1,415,094	44,479,477	1,522,555
Accrued expenses (Note 13)	33,945,547	-	23,762,843	-
Lease obligations, net of current portion (Note 7)	2,979,013	-	4,490,805	-
Long-term debt, net of current portion (Note 6)	66,258,673	-	68,131,939	-
Total liabilities	142,214,555	1,415,094	140,865,064	1,522,555
Fund Net Assets:				
Invested in capital assets, net of related debt	1,837,183	1,557,032	(603,770)	1,670,841
Unrestricted	89,971,216	5,279,144	91,969,881	5,494,634
Restricted	3,129,660	-	3,106,525	-
Total fund net assets	94,938,059	6,836,176	94,472,636	7,165,475
	\$ 237,152,614	\$ 8,251,270	\$ 235,337,700	\$ 8,688,030

Hurley Medical Center
Statements of Revenues, Expenses and Changes in Fund Net Assets
For the Years Ended June 30, 2005 and 2004

	2005		2004	
	Primary Government Hurley Medical Center	Component Unit Hurley Health Services	Primary Government Hurley Medical Center	Component Unit Hurley Health Services
Operating revenues:				
Net patient service revenues	\$ 277,628,457	\$ 4,315,995	\$ 260,871,368	\$ 5,801,099
Other operating revenues	24,216,879	17,055,893	26,402,220	16,432,522
Total operating revenues	301,845,336	21,371,888	287,273,588	22,233,621
Operating expenses:				
Salaries and wages	126,072,402	13,881,578	122,217,394	14,329,627
Professional services	30,523,309	81,259	31,380,465	45,513
Payroll taxes and fringes	46,699,433	2,610,760	33,444,426	2,564,389
Supplies	35,501,721	-	36,215,070	-
Purchased services and other	50,994,472	5,016,146	44,811,543	5,163,146
Depreciation and amortization expense	10,227,045	256,523	11,056,449	222,922
Total operating expenses	300,018,382	21,846,266	279,125,347	22,325,597
Operating income (loss)	1,826,954	(474,378)	8,148,241	(91,976)
Non-operating revenues (expenses):				
Interest expense	(2,957,176)	-	(4,969,907)	-
Investment income and unrestricted donations	2,302,979	145,079	928,769	25,937
Management fess to PHO and joint venture income (expense)	(718,499)	-	(1,672,618)	-
Total non-operating revenues (expenses)	(1,372,696)	145,079	(5,713,756)	25,937
Excess (deficiency) of revenues over expenses before other activity	454,258	(329,299)	2,434,485	(66,039)
Other				
Decrease in investment in Hurley Health Services	(329,299)	-	(66,039)	-
Assets released from restrictions for the purchase of capital assets	317,329	-	960,873	-
Total other	(11,970)	-	894,834	-
Excess (deficiency) of revenues over expenses before captial contributed, restricted fund activity and transfer of funds	442,288	(329,299)	3,329,319	(66,039)
Capital contributed, restricted fund activity and transfer of funds:				
Capital contributed	-	-	-	200,000
Restricted gifts and bequests	1,647,519	-	1,424,991	-
Income and investments	45,205	-	43,467	-
Transfer of fund to general fund:				
Capital asset additions	(317,329)	-	(960,873)	-
Other operating revenue (expenses)	(1,352,260)	-	(1,104,291)	-
Increase in fund net assets	465,423	(329,299)	2,732,613	133,961
Fund net assets - beginning of year	94,472,636	7,165,475	91,740,023	7,031,514
Fund net assets - end of year	\$ 94,938,059	\$ 6,836,176	\$ 94,472,636	\$ 7,165,475

See notes to financial statements.

Hurley Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2005 and 2004

	2005		2004	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Cash flows from operating activities:				
Receipts from patients and insurance companies	\$ 324,448,625	\$ 21,494,571	\$ 325,896,586	\$ 22,762,886
Payments to vendors	(194,621,084)	(8,016,250)	(168,253,963)	(7,801,888)
Payments to employees	(126,072,402)	(13,881,578)	(122,217,394)	(14,329,627)
Net cash provided by operating activities	3,755,139	(403,257)	35,425,229	631,371
Cash flows from investing activities:				
Distributions from joint ventures	1,808,126	-	2,675,000	46,011
Investment in joint venture	-	-	(1,742,000)	-
Investment in Hurley Health Services	-	-	(200,000)	200,000
Purchases of assets whose use is limited	(56,948,926)	(326,912)	(88,914,463)	-
Sale of assets whose use is limited	58,122,216	-	61,700,874	-
Purchase of stock certificates	-	-	-	(1,500)
Sale of stock certificates	-	1,500	-	-
Payments on notes receivable	-	30,000	-	24,500
Interest on investments	2,348,184	43,524	972,236	10,966
Net cash provided by (used in) investing activities	5,329,600	(251,888)	(25,508,353)	279,977
Cash flows from non-capital financing activities:				
Net proceeds from contributions restricted for specific purposes	1,647,519	-	1,424,991	-
Joint venture income	(3,396,442)	-	(3,751,595)	-
Net cash used in non-capital financing activities	(1,748,923)	-	(2,326,604)	-
Cash flows from capital and related financing activities:				
Repayment of long-term debt and capital leases	(3,413,948)	-	(3,196,359)	-
Interest paid on long-term debt	(4,690,886)	-	(4,969,907)	-
Proceeds from termination of interest rate swap	1,568,119	-	-	-
Purchase of capital assets	(9,408,570)	(71,105)	(7,270,302)	(14,293)
Proceeds from sale of assets	62,863	31,833	139,836	37,739
Net cash provided by (used in) financing activities	(15,882,422)	(39,272)	(15,296,732)	23,446
Net increase (decrease) in cash and cash equivalents	(8,546,606)	(694,417)	(7,706,460)	934,794
Cash and cash equivalents at beginning of year	30,010,343	3,148,099	37,716,803	2,213,305
Cash and cash equivalents at end of year	\$ 21,463,737	\$ 2,453,682	\$ 30,010,343	\$ 3,148,099

See notes to financial statements.

(continued)

Hurley Medical Center
Statements of Cash Flows (continued)
For the Years Ended June 30, 2005 and 2004

	2005		2004	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Cash flows from operating activities:				
Operating income (loss)	\$ 1,826,954	\$ (474,378)	\$ 8,148,241	\$ (91,976)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation and amortization	10,227,045	256,523	11,056,449	222,922
Provision for bad debt	34,970,385	-	26,964,785	-
Amortization of bond discounts, issuance costs, and other deferred charges	278,553	-	445,053	-
Amortization of deferred defeasance gain	216,734	-	219,061	-
(Gain) loss on disposal of assets	(787,267)	-	298,236	-
Provision for income taxes	-	(58,341)	-	-
Contribution released from restrictions	(1,352,260)	-	(1,104,291)	-
Changes in operating assets and liabilities:				
Patient and other accounts receivable	(45,867,185)	122,683	(14,261,591)	529,265
Inventories	(323,189)	(40,081)	33,371	-
Prepaid expenses and other	6,734	(102,204)	132,319	(51,213)
Interest receivable on assets whose use is limited	(118,036)	-	59,310	-
Accounts payable and taxes withheld	(47,908)	(229,791)	(967,182)	143,326
Accrued expenses	4,724,579	122,332	4,401,468	(120,953)
 Net cash provided by operating activities	 \$ 3,755,139	 \$ (403,257)	 \$ 35,425,229	 \$ 631,371

Non-cash transactions:

The Medical Center recorded a decrease in the investment in subsidiary in the amount of \$329,299 in 2005 and a decrease in the investment in subsidiary in the amount of \$66,039 in 2004.

The Medical Center recorded an increase in the investment from current operations in joint ventures in the amount of \$2,677,943 and \$2,078,977 for 2005 and 2004, respectively.

The Medical Center purchased capital assets with the issuance of long term debt in the amount of \$35,625 in 2005.

During 2005 Hurley Practice Management Services sold their investment in a joint venture with the issuance of a Note Receivable in the amount of \$415,500.

See notes to financial statements.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

1. Summary of significant accounting policies

Organization and reporting entity:

Hurley Medical Center (Medical Center) is a component unit of the City of Flint, Michigan. The Medical Center provides inpatient, outpatient, and emergency care services in Genesee and surrounding counties. As an instrumentality of a political subdivision of the State of Michigan, as described in Section 115 of the Internal Revenue Code, the Medical Center is exempt from Federal income taxes.

The City of Flint Hospital Building Authority (the Authority) is a blended component unit of the Medical Center and the City of Flint. The Authority only serves the Medical Center by facilitating the issuance of debt for certain capital improvements and equipment via a lease contract. In accordance with generally accepted accounting principles, the lease transactions between the Medical Center's and the Authority have been eliminated and all debt and related assets have been recorded in the Medical Center's financial statements.

Hurley Health Services (HHS), a municipal support organization, is a wholly owned subsidiary of the Medical Center, and is reported as a component unit. HHS, on a consolidated basis, is comprised of two non-profit entities (HHS and The Hurley Clinics, THC) and one "for profit" corporation (Hurley Practice Management Services, HPMS).

Proprietary fund accounting:

The Medical Center utilizes the proprietary fund method of accounting whereby, revenues and expenses are recognized on the accrual basis. The proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict Governmental Accounting Standards board (GASB) pronouncements, in which case GASB prevails.

Basis of presentation:

In 2002, the Medical Center adopted GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Under GASB 34, the Medical Center is classified as a special purpose government and is required to present statements required for enterprise funds.

Cash and cash equivalents:

Cash and cash equivalents include investments in highly liquid, debt instruments with a maturity of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements or with third-party payors.

Assets limited as to use:

Assets limited as to use include:

- Assets set aside by the Board of Managers for identified purposes, over which the Board retains control, and may at its discretion subsequently use for other purposes.
- Proceeds of debt issues and funds of the Medical Center deposited with a trustee and limited to use in accordance with the requirements of a bond indenture.
- Assets restricted by outside donors.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

1. Summary of significant accounting policies - (continued)

Investments and investment income:

The Medical Center accounts for its investments in accordance with GASB No. 31, *Accounting for Certain Investments and for External Investment Pools*. All investments are valued at their fair values in the balance sheet except money market investments and interest earning investment contracts that have a remaining maturity of less than one year at the time of purchase. These investments are carried at amortized cost. Unrealized gains and losses are included in the statement of operations as non-operating revenues - investment income.

Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and investment income on assets deposited in the self-insurance trust are reported as operating revenues - other revenue. Investment income from all other general fund investments and investment income of endowment funds are reported as non-operating revenue. Investment income and gains (losses) on investments of donor-restricted funds are added to (deducted from) the appropriate restricted fund balance.

The investment in Hurley Health Services, Inc. (Subsidiary) and other joint ventures are recorded on the equity method of accounting.

Accounts receivable:

Accounts receivable for patients, insurance companies and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical loss rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Medical Center's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for uncollectible accounts in the period they are deemed to be uncollectible. The allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Inventories:

Inventories are stated at the lower of cost (first-in, first-out) or market.

Bond issuance cost:

Costs related to the issuance of bonds are deferred and amortized over the life of the bonds. Costs amortized during periods of construction are added to the cost of the related projects.

Deferred defeasance loss:

The defeasance loss associated with defeased debt is capitalized and amortized over the life of the new debt.

Property, plant, and equipment:

Property, plant, and equipment are stated at cost and depreciated over the estimated useful lives of the related assets. Prior to 1997, the Medical Center utilized an accelerated method of depreciation for substantially all assets. In 1997, the Medical Center switched to straight-line depreciation for all new acquisitions.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

1. Summary of significant accounting policies - (continued)

Compensated absences:

The Medical Center's employees earn vacation days at varying rates depending on years of service and job classification. Employees may accumulate vacation days up to a specified maximum. The Medical Center's policy is to accrue such unpaid vacation days as they are earned. The estimated amount of vacation days payable is reported as a current liability in both 2005 and 2004.

Employees of the Medical Center generally are eligible for receiving a portion of unused sick leave benefits only upon retirement, death, or duty-related disability. The Medical Center's policy is to recognize these sick leave benefits at the time an employee becomes vested for retirement or duty-related disability, or in the case of death. The estimated amount of sick leave payable for employee meeting these requirements is reported as a noncurrent liability in both 2005 and 2004.

Certain employee groups, however, are eligible to receive a portion of unused sick leave benefits on an annual basis. The Medical Center's policy is to accrue such unpaid sick leave benefits as they are earned. The estimated amount of sick leave payable for employees eligible to receive a portion of unused sick leave benefits on an annual basis is reported as a current liability in both 2005 and 2004.

Classification of fund net assets:

Fund net assets of the Medical Center are classified in three components. Fund net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are non-capital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net patient service revenue:

Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payors for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Approximately 75% and 76% of the Medical Center's revenues are based on participation in the Blue Cross Blue Shield, Medicare, and Medicaid programs for the years 2005 and 2004, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Operating revenues and expenses:

The Medical Center's statement of revenues, expenses and changes in fund net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Medical Center's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

1. Summary of significant accounting policies - (continued)

Restricted resources:

When the Medical Center has both restricted and unrestricted resources available to finance a particular program, it is the Medical Center's policy to use restricted resources before unrestricted resources.

Charity care:

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Estimated self-insured malpractice costs:

The provision for estimated self-insured medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The estimate for claims incurred but not reported is based on an actuarial determination.

Interest expense:

Interest expense is charged to operations as incurred, except that interest on funds borrowed for major construction projects, which is capitalized as a component of the cost of the related projects during the period that the borrowed funds are owed.

Income taxes:

The Medical Center and HHS are exempt from income taxes except for HHS's subsidiary, Hurley Practice Management Services. A provision for income taxes (at statutory rates) has been provided for in the financial statements related to this entity's transactions.

Non-operating revenues and expenses:

The Medical Center categorizes joint ventures, investment income and operations that the Medical Center does not directly oversee as non-operating activities.

Estimates:

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications:

Certain prior year amounts have been reclassified to conform to current year presentation.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

2. Charity care

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies, and equivalent service statistics. The following information measures the level of charity care provided during the years ended June 30, 2005 and 2004.

	<u>2005</u>	<u>2004</u>
Charges foregone, based on established rates	<u>\$592,416</u>	<u>\$598,090</u>
Estimated costs and expenses incurred to provide charity care	<u>\$291,409</u>	<u>\$289,029</u>
Equivalent percentage of charity care patients to all patients served	<u>.09%</u>	<u>.09%</u>

3. Net patient service revenue

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare:

Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Most outpatient services are paid on an ambulatory payment classification system or fee schedule methodology. Inpatient nonacute services and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology subject to certain limitations.

Medicaid:

Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed based on a fee schedule methodology. Capital costs are paid on a cost reimbursement method

Blue Cross/Blue Shield:

Inpatient , acute care services are reimbursed at prospectively determined rates per discharge. These rates are based on the Medicare patient classification system and on Hospital specific costs. Outpatient services are reimbursed on a fee for service basis.

HMO/PPO:

Services rendered to HMO and PPO beneficiaries are paid at predetermined rates or as a percentage of Hospital charges.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare, Medicaid and Blue Cross/Blue Shield of Michigan programs and are subject to audit by fiscal intermediaries. The 2004 net patient service revenue decreased approximately \$1,530,000 due to prior year retroactive adjustments in excess of amounts previously estimated. The 2005 net patient service revenue increased approximately \$710,000 due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

4. Patient accounts receivable

Patient accounts receivable at June 30, 2005 and 2004, and revenues for the years then ended include estimated amounts due from various third-party payors which are computed in accordance with their respective reimbursement formulas.

In addition, the Medical Center has established an estimated allowance for uncollectible accounts of approximately \$26,100,000 and \$26,900,000 at June 30, 2005 and 2004, respectively.

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors at June 30, 2005 was as follows:

Medicare	11%
Medicaid	38
Blue Cross Blue Shield of Michigan	17
Other third-party payors and patients	34
	<hr/>
Total	100%

5. Assets limited as to use

Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets. Assets limited as to use at June 30, 2005 and 2004, consisted of the following:

	<u>2005</u>	<u>2004</u>
By Board for funded depreciation and capital improvements:		
Cash and cash equivalents	\$ 9,073,321	\$8,112,906
U.S. Government Securities (cost was \$31,466,708 and \$30,700,558 for 2005 and 2004, respectively)	31,337,550	30,141,291
Accrued interest receivable	82,791	58,460
	<hr/>	<hr/>
	40,493,662	38,312,657
By Board for self-insurance:		
Cash and cash equivalents	369,423	100,350
U.S. Government Securities (cost was \$3,314,555 and \$2,303,961 for 2005 and 2004, respectively)	3,352,941	2,288,061
Mutual funds (cost was \$4,821,171 and \$3,758,374 for 2005 and 2004, respectively)	5,660,738	4,475,203
Accrued interest receivable	34,964	30,117
	<hr/>	<hr/>
	9,418,066	6,893,731
Total Board designated	<hr/>	<hr/>
	\$49,911,728	\$45,206,388

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

5. Assets limited as to use – (continued)

	<u>2005</u>	<u>2004</u>
Under bond indenture agreement - held by trustee:		
Cash and cash equivalents	\$9,325,417	\$14,382,932
U.S. Government Securities (cost was \$2,870,798 and \$2,881,614 for 2005 and 2004, respectively)	2,944,675	2,954,829
Accrued interest receivable	93,405	4,559
	<u>\$12,363,497</u>	<u>\$17,342,320</u>
Restricted:		
Cash and cash equivalents	<u>\$ 369,340</u>	<u>\$ 330,589</u>

6. Lease purchase commitments and long-term debt

	<u>2005</u>	<u>2004</u>
Lease purchase contract, revenue refunding bonds, Series 1995A, with annual payments ranging from \$2,275,000 in 2000 to \$1,130,000 in 2007, plus interest at 5.25% to 7.00% through 2007.	\$ 2,200,000	\$3,205,000
Lease purchase contract, revenue refunding bonds, Series 1998A, with annual payments ranging from \$485,000 in 2000 to \$1,315,000 in 2021, plus interest at 4% to 5.375% through 2021.	14,705,000	15,290,000
Lease purchase contract, revenue refunding bonds, Series 1998B, with annual payments ranging from \$335,000 in 2000 to \$1,320,000 in 2029, plus interest at 4% to 5.375% through 2029.	18,510,000	18,895,000
Lease purchase contract, revenue refunding bonds, Series 2003, with annual payments ranging from \$1,680,000 in 2008 to \$3,550,000 in 2021, plus interest at 6.00% to 6.50% through 2021.	35,000,000	35,000,000
	70,415,000	72,390,000
Less unamortized bond discount	<u>2,066,327</u>	<u>2,283,061</u>
	68,348,673	70,106,939
Less current portion	<u>2,090,000</u>	<u>1,975,000</u>
Net long-term debt	<u>\$66,258,673</u>	<u>\$68,131,939</u>

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

6. Lease purchase commitments and long-term debt - (continued)

The following is a reconciliation of the future principal and interest payments to the recorded liability at June 30, 2005:

2006	\$ 6,054,444
2007	6,533,394
2008	6,540,244
2009	6,538,869
2010	6,541,219
2011	6,533,225
After 2011	<u>69,953,947</u>
	108,695,342
Less amount representing interest	<u>38,280,342</u>
Total lease purchase commitments and long-term debt	<u>\$ 70,415,000</u>

The revenue refunding bonds are payable from the revenues of the Medical Center pursuant to lease/purchase agreements between the Medical Center and the City of Flint Building Authority (the Authority). Under terms of the lease/purchase agreements, the Medical Center has transferred title to substantially all of its facilities to the Authority and leases such facilities from the Authority. Ownership of the facilities reverts to the Medical Center upon payment of the bonds. Rental payments to the Authority are equal to the amounts required to make principal and interest payments on the bonds.

The net revenues of the Medical Center are pledged for payment of principal and interest on the variable rate demand revenue rental and revenue refunding bonds. Accordingly, the financial statements of the Medical Center include the facilities as if owned by the Medical Center and the bonds as if issued by the Medical Center.

The lease purchase agreements contain certain restrictive covenants.

During 2005, the Medical Center entered into an interest rate swap agreement with a swap provider to swap a portion of their fixed rate debt for a variable interest rate in order to take advantage of fluctuations in the interest rate. At June 30, 2005, the notional principal amount of the Medical Center's portion of the outstanding interest rate swap agreement was \$35 million. The agreement effectively changes the Medical Center's interest rate exposure on \$35 million of fixed percent bonds due July 1, 2008 and July 1, 2020 to a variable rate. The interest rate swap agreement matures on July 1, 2011.

An unrealized loss of \$856,910 at June 30, 2005 has not been recorded in accordance with governmental accounting standards.

During 2005, an interest rate swap agreement was terminated resulting in a gain of \$1,568,119, which was recorded against interest expense in the statement of revenues and expenses.

7. Lease obligations

The Medical Center has a capital lease agreement for equipment and software expiring in 2007 and 2008. The equipment and software have been capitalized and the related obligation recorded using the interest rate implicit in the lease. The assets are being depreciated over their useful lives. The amount of assets under the capital leases was \$539,606 and \$503,987 at June 30, 2005 and 2004, respectively, and the related accumulated depreciation was \$257,929 and \$157,194 at June 30, 2005 and 2004, respectively.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

7. Lease obligations – (continued)

The Medical Center also has two sale-leaseback agreements with a bank for equipment expiring in 2008 and 2009. The equipment has been capitalized and the related obligation recorded using the interest rate implicit in the lease. The assets are being depreciated over their useful lives. The sale-leaseback agreements contain restrictive covenants containing minimum cash flow, minimum total and pledged liquid assets, minimum unrestricted net assets, and maximum liabilities to net asset ratio requirements.

The following is a reconciliation of the future minimum lease payments to the recorded liability at June 30, 2005:

2006	\$1,722,791
2007	1,706,330
2008	1,338,936
2009	<u>75,544</u>
 Total future minimum payments	 4,843,601
 Less amount representing interest	 <u>323,799</u>
 Total obligation under capital leases	 4,519,802
Less current portion	<u>1,540,789</u>
 Long-term obligation under capital leases	 <u><u>\$2,979,013</u></u>

8. Retirement plans

The most recent actuarial valuation providing the disclosures in accordance with Statement No. 25 and 27 is as of December 31, 2002. Significant details regarding the Medical Center's retirement plans are presented below:

Description of plans:

The Medical Center contributes to the City of Flint Employees Retirement System, which is a Single-Employer Public Employee Retirement System (PERS). It is the responsibility of the City of Flint PERS to function as an investment and administrative agent for the Medical Center with respect to the pension plans. The City of Flint PERS is administered by a board of trustees. Investments of the City of Flint PERS are made through Bank One Trust Department and the Northern Trust Company.

The Medical Center has three plan options covering substantially all employees of the Medical Center. The basic plan option, which is the Old Contributory Pension Plan (OCP), provides for employer contributions, as well as requiring employee contributions based upon a percent of pay. Benefits fully vest after 15 years of service or at age 55 with 10 years of service. Under the OCP, employees may retire any time after completion of 25 years of credited service or at age 55 with 10 years of credited service. The lifetime monthly retirement benefit under the OCP is the participant's final average compensation (which is the average of the highest five out of the last ten years of credited service) times 2% of the first 25 years of credited service and 1% for every year thereafter.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

8. Retirement plans – (continued)

Description of plans: – (continued)

A second plan option is the Modified Contributory Pension Plan (MCP) which provides for employer contributions, as well as requiring employee contributions, based upon a percent of pay, but at rates higher than those required under the OCPP. Benefits fully vest after 15 years of service or at age 55 with 10 years of service. Employees may retire any time after completion of 25 years of credited service or at age 55 with 10 years of credited service. The lifetime monthly retirement benefit under the MCP is the participant's final average compensation (which is the average of the highest three out of the last five years of credited service) times 2% of the first 15 years of credited service, plus 2.2% of the next 10 years of credited service, and 1% of every year of credited service beyond year 25.

A third plan option is the Hurley Alternative Pension Plan (HAPP) which provides for only an employer contribution and no employee contribution. Benefits fully vest after 10 years of credited service and a normal retirement age of 60. There are provisions for early retirement at age 55 with a reduced benefit (based upon actuarial assumptions to reflect the additional years of benefit payments). The lifetime monthly retirement benefit under the HAPP is the participant's final average compensation (which is the average of the highest five out of the last ten years of credited service) times 1.5% for all years of credited service.

Benefit provisions are authorized by contract.

Non-exempt employees (members of bargaining units) may participate in either the MCP or the HAPP. Exempt employees may participate in only one of any of the three plans (MCP, HAPP, or OCPP).

The PERS issues a separate financial report which can be obtained from the Pension and Payroll Department at City Hall – City of Flint, Michigan.

Funding policy:

Employee contributions –

	<u>Exempt</u>	<u>Non-exempt</u>
OCPP	3.75% of first \$4,200 of compensation 5.75% on compensation over \$4,200	Not eligible
MCP	4.5% of first \$4,200 of compensation plus 6.5% of compensation over \$4,200	7% of pay
HAPP	None	None

The Medical Center makes employer contributions in accordance with funding requirements determined by an independent actuary. If a member leaves service, he or she may withdraw his or her employee contributions together with interest.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

8. Retirement plans – (continued)

Actuarial assumptions:

The information presented in the required supplementary schedules was determined as a part of the actuarial valuation made at December 31, 2002.

Valuation date	December 31, 2002
Actuarial cost method	Individual Entry Age
Amortization method	Level percent
Remaining amortization period	30 years for unfunded actuarial accrued liabilities 10 years for valuation assets in excess of actuarial accrued liabilities 4 year smoothed market
Asset valuation method	
Actuarial assumption:	
Investment rate of return	7.75%
Projected salary increases	3.95% - 7.55%
Includes wages inflation at	3.75%
Cost of living adjustments	None

Annual required contributions rates:

	<u>Year Ended June 30,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Annual Required Contribution (ARC) rate as a percent of covered payroll	8.39%	0.0%	0.0%
Contributions made	8.39%	0.0%	0.0%
Annual pension costs – for year ended	\$8,967,695	\$ -	\$ -
Contributions made – for year ended	\$8,967,695	-	-

The net pension obligation at June 30, 2005 and 2004 was \$-0-.

Defined Contribution Plan

The Medical Center has a defined contribution plan for employees who meet certain requirements as to date of hire. Contributions to the plan are 4.5% of the employee's annual compensation. Each employee's interest is vested as specified in the plan. Pension expense included in the statement of revenues and expenses was \$551,267 and \$442,197 for the years ending June 30, 2005 and 2004, respectively.

Profit Sharing and 403(b) Retirement Plan

HHS has a qualified 401(k) profit sharing plan for HPMS employees. Eligible employees, those that have attained the age of 21 and completed 90 days of service, may defer up to fifteen percent (15%) of their salary. HHS may make a discretionary contribution. HHS contributions to the 401(k) plan were \$35,262 and \$28,230 for 2005 and 2004, respectively. HHS also maintains two tax deferred annuity plans under section 403(b) of the Internal Revenue codes. Under the plans, HHS and THC employees may elect to defer up to a percentage of their salary, subject to the Internal Revenue Service limits. HHS may make a discretionary contribution. HHS's contributions to the 403(b) plans amounted to \$331,346 and \$342,059 for 2005 and 2004, respectively.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

9. Leases

Hurley Medical Center and Hurley Health Services lease office space under various operating leases. Certain operating leases contain rental escalation clauses that are based on prime rate at a future date and purchase options at fair market value. The following is a schedule, by year, of future minimum rental payments required under noncancellable operating leases as of June 30, 2005:

	<u>Hurley Medical Center</u>	<u>Hurley Health Services</u>
2006	\$ 1,644,130	\$ 977,704
2007	1,655,336	841,538
2008	1,439,142	805,448
2009	1,280,243	665,132
2010	989,416	601,457
2011 and after	1,609,917	2,088,313
Total minimum payments required	<u>\$8,618,184</u>	<u>\$5,979,592</u>

Rental expense for all operating leases for Hurley Medical Center for the years ended June 30, 2005 and 2004 amounted to \$4,227,572 and \$4,398,761, respectively. Rental expense for all operating leases for Hurley Health Services for the years ended June 30, 2005 and 2004, amounted to \$1,095,791 and \$1,122,784, respectively, including rental income paid to Hurley Medical Center of \$465,395 and \$498,416 for the years ended June 30, 2005 and 2004, respectively

10. Contingencies and commitments

Contingencies:

Malpractice claims have been asserted against the Medical Center by various claimants. The claims are in various stages of assertion, including some that have been brought to trial. Counsel is unable to conclude about the ultimate outcome of the actions, however, it is probable that certain actions will result in unfavorable settlements for the Medical Center. There also are known incidents occurring through June 30, 2005 that may result in the assertion of additional claims. Management is of the opinion that the settlement of those claims probable of unfavorable outcome, as well as the settlement, if any, of such other asserted and unasserted claims, are within the self-insurance limits. Consequently, management believes that such settlements will not significantly affect the Medical Center's financial results. The Medical Center maintains an irrevocable trust to be used for the payment of settlements. The Medical Center funds the trust based upon an annual actuarial determination. The Medical Center purchased a stop loss insurance policy relating to malpractice claims, which will limit the future claims that will be paid from the irrevocable trust.

There are various legal actions pending against Hurley Health Services, its subsidiaries, and certain employees. Due to the inconclusive nature of these actions, it is not possible for legal counsel of Hurley Health Services to determine in the aggregate either the probable outcome of these actions or a reasonable estimate of Hurley Health Services ultimate liability, if any. Hurley Health Services maintains what it believes to be adequate coverage of malpractice, errors and omissions, and directors and officers insurances to cover any possible claims.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

10. Contingencies and commitments – (continued)

Commitments:

As of June 30, 2005, Hurley Practice Management Services is contingently liable as guarantor with respect to \$3,500,000 of indebtedness (various debt instruments secured by essentially all of the assets of Hurley/Binson's Medical Equipment, Inc.) of Hurley/Binson's Medical Equipment, Inc. Hurley Practice Management Services owns fifty percent of Hurley/Binson's Medical Equipment, Inc. The book value of the investment is \$1,546,479 at June 30, 2005. No material loss is anticipated by reason of such guarantee. There are no recourse rights in the event of default by Hurley/Binson's Medical Equipment, Inc.

11. Post-retirement health care benefits

Effective for retirements on or after July 1, 1983, Hurley Medical Center provides a portion of health insurance premiums for retired employees. The insurance premium for retired employees ranges from \$168 to \$1,499 per month to age 65 and a Medicare supplement after age 65. Retired exempt employees receive full coverage at no cost to the retiree. Retired non-exempt employees pay the full amount or a portion of the premium. No payment is made if the retired employee is covered under other employment. The estimated cost of such benefits is accrued based on a level percent of payroll. Accrued costs charged to expense were \$3,099,680 and \$3,060,050 in the years ended June 30, 2005 and 2004, respectively. The number of participants eligible to receive benefits was 642 and 617 in the years ended June 30, 2005 and 2004, respectively. The Medical Center maintains a trust to be used for payment of the Center's portion of health insurance premiums for retired employees.

12. Other

Prior to 1993, the Medical Center was classified under the jurisdiction of the Financial Accounting Standards Board (FASB) and the financial statements and related disclosures were in compliance with FASB requirements. In January 1993, the Accounting Standards Board issued Statements of Auditing Standard No. 69 *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles (GAAP)."* This statement revised the GAAP Hierarchy which is the auditor's uniform standard for judging the fairness of the overall presentation of the financial statements. As a result of the issuance of SAS 69, all governmental entities and component units thereof are to be classified under the jurisdiction of the Governmental Accounting Standard Board (GASB).

The Medical Center's disclosures 1-11 remained similar to the prior year to maintain the comparability of the Medical Center to the health care industry. The following are the additional disclosures required by the GASB:

Deposits:

The Medical Center's deposits consist of checking and savings accounts and money market funds. At year end, the carrying amount of the Medical Center's deposits was \$22,282,951 (excluding petty cash of \$11,426), and the bank balance was \$25,188,191. Of the bank balance, \$553,467 was covered by federal depository insurance. The bank balance includes \$18,768,160 of money market funds that are collateralized by securities not in the name of the Medical Center. The rest of the bank balance, or \$5,866,564, was not insured or collateralized.

HHS's deposits consist of checking accounts and money market funds. Deposits are recorded on the financial statements as cash and cash equivalents. At year end, the carrying amount of HHS's deposits (excluding petty cash) was \$2,778,617 and the bank balance was \$3,054,127. The bank balance was higher than the carrying value due to outstanding checks that had not yet cleared the bank at June 30, 2005. Of the bank balance, \$300,000 was covered by federal depository insurance.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

12. Other – (continued)

Investments:

Michigan Compiled Laws section 129.91 (Public Act 20 of 1943, as amended), authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The retiree health care fund is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed \$250 million), debt or equity of certain small business, certain state and local government obligations and certain other specified investment vehicles.

The Medical Center currently has designated four financial institutions for the deposit of its funds. The investment policy adopted by the Board in accordance with Public Act 196 of 1997 has authorized investment in all of the items listed above. The Medical Center's deposits and investment policies are in accordance with statutory authority.

The Medical Center's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial credit risk of investments:

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Medical Center will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Medical Center has a policy for custodial credit risk that requires the safe keeping agent to undergo an annual evaluation of credit worthiness by the Chief Investment Officer through the review of the annual financial statements and/or the use of credit rating agencies. The safe keeping agent is a member of the Securities Investor Protection Corporation (SIPC). Securities held in the safe keeping account are insured up to \$500,000 and cash is insured to \$100,000 through this program. The balance of the investments is not insured and is not registered with securities held by the counterparty or by its trust department or agent but not in the Medical Center's name. The investments subject to custodial credit risk at June 30, 2005 are as follows:

<u>Investment Type</u>	<u>Fair Value</u>	
U.S. government or agency bonds	\$ 8,318,349	Counterparty's trust department
U.S. government or agency bonds	9,993,950	Counterparty's
Commercial paper	1,000,716	Counterparty's trust department
Repurchase agreement	<u>18,306,862</u>	Counterparty's
	<u>\$37,619,877</u>	

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

12. Other - (continued)

Investments: - (continued)

Interest rate risk:

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Medical Center's investment policy indicates that no investment shall have, at the time of purchase, an average life of more than five years. Investments other than mortgage-backed securities may not have a maturity of more than 10 years. As of June 30, 2005, the Medical Center had the following investments and maturities.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities</u>		
		<u>Less than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>
U.S. government or agency bonds	\$18,402,973	\$ 6,413,065	\$ 6,255,228	\$5,734,679
U.S. government CMO's	18,154,135	19,334	18,134,801	-
Commercial paper	1,000,716	1,000,716	-	-
Repurchase agreement	18,306,862	18,306,862	-	-
	<u>\$55,864,686</u>	<u>\$25,739,977</u>	<u>\$24,390,029</u>	<u>\$5,734,679</u>
	100.00%	46.08%	43.66%	10.27%

Credit risk:

As of June 30, 2005, the credit quality ratings of debt securities that are not explicitly guaranteed by the U.S. government are as follows:

	<u>Fair Value</u>	<u>Rating</u>	<u>Rating Organization</u>
U.S. government agency bonds	\$14,368,846	AAA	Standard & Poors
U.S. government CMO's	18,154,135	Not rated	
Commercial paper	1,000,716	A1+	Standard & Poors
Repurchase agreement	<u>18,306,862</u>	Not rated	
	<u>\$51,830,559</u>		

Concentration of credit risk:

The Medical Center's investment policy limits any single investment to 10% of the portfolio, with the exception of cash or U.S. treasuries, and further restricts the combined mortgage backed securities may not exceed 50% of the portfolio. No single investment exceeded 5% of the investment portfolio at June 30, 2005.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

12. Other - (continued)

Long-term debt:

Changes in the Medical Center's long-term debt (which is detailed in Note 6) and lease obligations (which is detailed in Note 9) is as follows:

	<u>2005</u>		<u>2004</u>	
	<u>Long-Term Debt</u>	<u>Lease Obligations</u>	<u>Long-Term Debt</u>	<u>Lease Obligations</u>
	<u>(Including</u>	<u>(Including</u>	<u>(Including</u>	<u>(Including</u>
	<u>Current Portion)</u>	<u>Current Portion)</u>	<u>Current Portion)</u>	<u>Current Portion)</u>
Liability at beginning of year	\$70,106,939	\$ 5,923,125	\$71,762,877	\$ 7,244,485
Additions:				
New lease obligations	-	35,625	-	-
Amortization of bond discount	216,734	-	219,062	-
Reductions:				
Payments	<u>(1,975,000)</u>	<u>(1,438,946)</u>	<u>(1,875,000)</u>	<u>(1,321,360)</u>
Liability at end of year	<u>\$68,348,673</u>	<u>\$ 4,519,804</u>	<u>\$70,106,939</u>	<u>\$ 5,923,125</u>

Deferred compensation:

The Medical Center offers a deferred compensation plan adopted in accordance with Internal Revenue Code Section 457A. The plan, available to substantially all employees, permits employees to defer a portion (i.e. the lesser of 100% of their total compensation, or \$14,000) of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death, or unforeseeable emergency.

The Plan investments have been placed into a qualified trust to shield the plan investments from the general creditors of a public corporation.

13. Self insurance

Hurley Medical Center is self insured for its hospital professional and patient general liability exposures. The Medical Center has established a self-insurance trust to assist in accumulating resources to fund excess insurance premiums and to pay claims.

The Medical Center's self insured retention is \$6 million for the first annual occurrence and \$4 million for each additional occurrence annually with excess claims made coverage up to \$15 million annually. Claims in excess of \$15 million are to be covered by the Medical Center. The Medical Center employs the use of an actuary to provide an analysis of the existing claims and to estimate the liability for incurred but not reported (IBNR) claims.

The carrying amount of liabilities for unpaid claims amounted to \$24,242,445 and \$21,545,354 at June 30, 2005 and 2004, respectively.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

13. Self insurance – (continued)

The following represents the change in the aggregate liabilities for claims and defense costs payable for the years ended June 30, 2005 and 2004:

	<u>Claims and Defense Costs Payable</u>	
	<u>2005</u>	<u>2004</u>
Balance - beginning of year	\$21,545,354	\$19,553,190
Claims paid	(8,619,433)	(3,621,133)
Defense costs and other fund expenses	(2,155,973)	(2,365,278)
Excess insurance premium payments	(1,821,833)	(1,618,639)
Increase in claims liability	<u>15,294,330</u>	<u>9,597,214</u>
Balance - end of year	<u>\$24,242,445</u>	<u>\$21,545,354</u>
Insurance Trust assets (at market) - end of year	<u>\$ 3,603,534</u>	<u>\$ 2,311,714</u>

The Medical Center is self insured for workers' compensation claims. Current claims expense for the year ended June 30, 2005 and 2004 was \$1,386,339 and \$1,331,937, respectively.

14. Joint ventures

Hurley Medical Center participates in six privately held joint ventures, Greater Flint Area Hospital Imaging Center, Inc., (GFAHIC), Flint Health Systems Imaging Center, Inc., (FHSIC), HGH, Inc., (HealthPlus Partners), Hurley PHO of Mid-Michigan, Michigan Lithotripsy Network and Genesys Hurley Cancer Institute. Each corporate joint venture is recorded in the financial statements in accordance with Accounting Principles Board Statement 18 on the equity method of accounting.

GFAHIC and FHSIC provide magnetic resonance imaging (MRI) services to the Greater Flint and Genesee County community. The ownership of both Corporations is allocated between Hurley Medical Center, Genesys Regional Medical Center, and McLaren Regional Medical Center. The joint venture provides that each participant shares in the annual earnings/loss of the Corporations. The net investment by the Medical Center at June 30, 2005 and 2004 was \$3,713,657 and \$2,994,888, respectively. A total of \$1,800,000 and \$2,675,000 was distributed to the Medical Center during the year ended June 30, 2005 and 2004, respectively.

HGH, Inc., is a joint venture among Hurley Medical Center, HealthPlus of Michigan, Inc., Genesys Regional Medical Center and Memorial Health Care Center. During 2004, Memorial Health Care Center withdrew from the joint venture and the remaining three entities contributed capital of \$1,742,000 each to the venture. The venture was established during 1995 to provide a methodology to enroll Medicaid patients in the statewide managed care initiative for Medicaid. The Medical Center has a negative net investment (obligation) of \$(702,570) and \$(425,040) at June 30, 2005 and 2004, respectively. The arrangement provides that the three entities will share in the income or losses of the joint venture.

Hurley PHO of Mid-Michigan is a joint venture between Hurley Medical Center and its medical staff. The venture was established during 1997 to provide vertically integrated continuous care which will facilitate the Medical Center participating in managed care contracts in the future. The Medical Center's net investment at June 30, 2005 and 2004 was \$395,991 and \$541,840, respectively. The arrangement provides that the Medical Center will be allocated 50 percent in income or losses of the joint venture.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

14. Joint ventures - (continued)

Michigan Lithotripsy Network is a joint venture between Hurley Medical Center and six other hospitals. The venture was established during 1999 to provide a mobile lithotripsy unit to be utilized by the participating hospitals. The Medical Center's net investment at June 30, 2005 and 2004 was \$31,061 and \$54,432, respectively. The arrangement provides that the seven hospitals will share equally in the income or losses of the joint venture.

Genesys Hurley Cancer Institute is a joint venture between Hurley Medical Center and Genesys Regional Medical Center. The venture was established during 2001, to provide outpatient oncology services, including laboratory, and radiation oncology. The Medical Centers net investment at June 30, 2005 and 2004 was \$1,928,130 and \$1,330,333 respectively. The arrangement provides that the two entities will share equally in the income or losses of the joint venture.

The financial statements of each entity are available at the Medical Center's administrative office.

HPMS has a 50 percent ownership in Hurley/Binson's Medical Equipment, Inc. The equity method of accounting was adopted for this investment, which was \$1,456,479 at June 30, 2005. Investment loss recognized in the year ended June 30, 2005 using the equity method was \$178,310.

15. Related party transactions

The Medical Center provides services to one of its joint ventures, HGH, Inc. As of June 30, 2005 and 2004, the net settlement receivable from HGH, Inc. was \$8,033,365 and \$6,280,516, respectively and is included in patient accounts receivable on the balance sheet. The net patient revenue recorded from HGH, Inc. was \$19,757,125 and \$18,749,639 for the years ended June 30, 2005 and 2004, respectively.

The Medical Center pays subsidies and management fees for services rendered to HHS. Management fees and contributions from the Medical Center to HHS for the years ended June 30, 2005 and 2004 amounted to \$15,751,845 and \$15,208,991, respectively, of which \$12,355,403 and \$11,437,856, respectively, is staff and service contracts and \$3,396,442 and \$3,771,135, respectively, is network management fees. Amounts paid by HHS to the Medical Center for rent and other miscellaneous expenses for the years ending June 30, 2005 and 2004 amounted to \$841,687 and \$666,605, respectively.

Included in "Other operating revenues" of HHS are management fees and marketing fees for services rendered paid by Hurley/Binson's Medical Equipment, Inc., a related party to HPMS. Management fee and marketing income from the Hurley/Binson's Medical Equipment, Inc. for the years ended June 30, 2005 and 2004, amounted to \$122,968 and \$126,314, respectively, of which \$84,615 and \$70,171, respectively, is a receivable at year end. HPMS and HHS purchase courier services from Hurley/Binson's Medical Equipment, Inc. in the amount of \$240,000 annually.

16. Subsequent events

City of Flint Public Employer Retirement System (City of Flint PERS)

During the fiscal year ended June 30, 2004, seven of nine employee unions plus the exempt employees voted to change participation from the City of Flint PERS to the Michigan Municipal Public Employees Retirement System (MERS). The process to effectuate the transfer began July 1, 2005. Employer contribution rates of the MERS plan are expected not to be greater than those of the City of Flint PERS.

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

17. Capital assets and depreciation

Property, plant and equipment and the related accumulated depreciation at June 30, 2005 are summarized by categories as follows:

	Capital Assets			Accumulated Depreciation		
	June 30, 2004	Additions	Transfers	June 30, 2005	June 30, 2004	June 30, 2005
Hurley Medical Center:						
Land	\$ 3,667,589	\$ 27,883	\$ -	\$ 3,695,472	\$ -	\$ -
Land improvements	3,852,985	28,231	(397)	3,880,819	3,487,163	3,573,127
Buildings:						
Medical center building	105,347,482	1,093,142	(67,106)	106,373,518	82,107,190	85,304,935
Parking structure	2,527,293	4,435	-	2,531,728	2,159,781	2,250,112
Nurses' residence	1,520,413	204,967	-	1,725,380	1,336,027	1,364,137
Interns' apartment	303,482	-	-	303,482	274,966	279,003
Prospect street apartments	1,253,073	-	-	1,253,073	1,140,075	1,164,255
Power plant	2,350,495	-	-	2,350,495	1,698,797	1,816,603
Rental property	350,497	-	-	350,497	335,381	339,256
Health and fitness center	4,565,319	-	-	4,565,319	3,242,989	3,450,875
Park Plaza	1,258,501	-	-	1,258,501	906,511	968,726
Physicians' office building	329,816	6,750	-	336,566	218,388	234,811
Northpointe Clinic	1,778,012	-	-	1,778,012	406,569	460,613
Davison Clinic	1,901,857	-	-	1,901,857	378,202	434,025
Longway Eastside Campus bldg.	4,027,518	63,539	-	4,091,057	517,459	660,930
Total buildings	127,513,758	1,372,833	(67,106)	128,819,485	94,722,335	98,728,281
Machinery and equipment	94,105,463	6,342,523	(3,315,497)	97,132,489	72,422,087	75,299,393
Automotive equipment	363,471	14,085	(81,159)	296,397	289,518	237,707
Construction in progress	1,627,192	9,444,195	(7,785,556)	3,285,831	-	-
Total Hurley Medical Center	\$231,130,458	\$17,229,750	\$(11,249,715)	\$237,110,493	\$170,921,103	\$177,838,508
Hurley Health Services:						
Leasehold improvements	\$ 1,285,240	\$ 775	\$ -	\$ 1,286,015	\$ 269,636	\$ 308,198
Equipment and furnishings	2,087,237	70,326	(81,833)	2,075,730	1,432,000	1,496,515
Total Hurley Health Services	\$ 3,372,477	\$ 71,101	\$ (81,833)	\$ 3,361,745	\$ 1,701,636	\$ 1,804,713

Hurley Medical Center
Notes to Financial Statements
June 30, 2005 and 2004

17. Capital assets and depreciation -- (continued)

Property, plant and equipment and the related accumulated depreciation at June 30, 2004 are summarized by categories as follows:

	Capital Assets				Accumulated Depreciation		
	June 30, 2003	Additions, at Cost	Transfers/ Retirements	June 30, 2004	June 30, 2003	Depreciation Charged to Expense	Transfers/ Retirements June 30, 2004
Hurley Medical Center:							
Land	\$ 3,667,589	\$ -	\$ -	\$ 3,667,589	\$ -	\$ -	\$ -
Land improvements	3,852,985	-	-	3,852,985	3,396,063	91,100	3,487,163
Buildings:							
Medical center building	105,044,698	839,263	(536,479)	105,347,482	79,146,523	3,492,499	82,107,190
Parking structure	2,527,293	-	-	2,527,293	2,069,235	90,546	2,159,781
Nurses' residence	1,520,413	-	-	1,520,413	1,318,075	17,952	1,336,027
Interns' apartment	303,482	-	-	303,482	270,915	4,051	274,966
Prospect street apartments	1,253,073	-	-	1,253,073	1,115,206	24,869	1,140,075
Power plant	2,350,495	-	-	2,350,495	1,580,358	118,439	1,698,797
Rental property	350,497	-	-	350,497	331,506	3,875	335,381
Health and fitness center	4,565,319	-	-	4,565,319	3,033,066	209,923	3,242,989
Park Plaza	1,258,501	-	-	1,258,501	844,296	62,215	906,511
Physicians' office building	329,816	-	-	329,816	200,917	17,471	218,388
Northpointe Clinic	1,778,012	-	-	1,778,012	349,775	56,794	406,569
Davison Clinic	1,901,857	-	-	1,901,857	322,379	55,823	378,202
Longway Eastside Campus bldg.	4,027,518	-	-	4,027,518	376,106	141,353	517,459
Total buildings	127,210,974	839,263	(536,479)	127,513,758	90,958,357	4,295,810	94,722,335
Machinery and equipment	93,914,689	6,104,071	(5,913,297)	94,105,463	71,266,449	6,644,647	72,422,087
Automotive equipment	377,101	19,806	(33,436)	363,471	294,719	24,891	289,518
Construction in progress	1,320,031	7,270,301	(6,963,140)	1,627,192	-	-	-
Total Hurley Medical Center	\$230,343,369	\$14,233,441	\$(13,446,352)	\$231,130,458	\$165,915,588	\$11,056,448	\$170,921,103
Hurley Health Services:							
Leasehold improvements	\$ 1,295,224	\$ -	\$ (9,984)	\$ 1,285,240	\$ 230,310	\$ 40,927	\$ 269,636
Equipment and furnishings	2,202,344	14,493	(129,602)	2,087,237	1,367,339	176,956	1,432,000
Total Hurley Health Services	\$ 3,497,568	\$ 14,493	\$ (139,586)	\$ 3,372,477	\$ 1,597,649	\$ 217,883	\$ 1,701,636

Required Supplementary Information

**Hurley Medical Center Division
City of Flint Employees Retirement System
Required Supplementary Information
Analysis of Funding Progress**

<u>Plan Year End</u>	<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability Attained Age (AAL)(b)</u>	<u>(Unfunded) Over Funded AAL (a - b)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>(UAAL) as % of Payroll (b - a)(c)</u>
6-30-97	12-31-95	\$238,204,021	\$220,503,557	\$17,700,464	108.0%	\$87,333,791	0.0%
6-30-98	12-31-96	257,531,709	242,476,930	15,054,779	106.2	83,112,658	0.0
6-30-99	12-31-97	301,060,938	259,985,429	41,075,509	115.8	87,651,874	0.0
6-30-00	12-31-98	322,497,186	281,563,941	40,933,239	112.7	96,417,303	0.0
6-30-01	12-31-99	340,608,779	306,134,487	34,474,292	111.3	107,246,608	0.0
6-30-02	12-31-00	354,306,658	328,489,881	25,816,777	107.9	105,102,019	0.0
6-30-03	12-31-01	367,058,240	333,802,804	33,255,436	110.0	103,411,340	0.0
6-30-04	12-31-02	357,836,531	399,476,922	(41,640,391)	89.6	103,802,756	40.1
6-30-05	12-31-02	357,836,531	399,476,922	(41,640,391)	89.6	103,802,756	40.1

Supplementary Information

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

We have audited the financial statements of the business-type activities of Hurley Medical Center (a component unit of the City of Flint, Michigan) for the year ended June 30, 2005. Our audit was made for the purpose of expressing an opinion on the basic financial statements taken as a whole. The accompanying additional information is presented for analysis purposes and is not a required part of the financial statements. The consolidating schedules have been subjected to the tests and other auditing procedures applied in the audits of the financial statements mentioned above and, in our opinion, are fairly stated in all respects material in relation to the financial statements taken as a whole, except said presentation includes certain departures from accounting principles under the Governmental Accounting Standards Board statements, as described below, but is intended to be a presentation comparable to hospital industry practices for not-for-profit health care providers. The primary changes are in the presentation of financial statements on a consolidated basis for the Medical Center and its component unit and reflecting the provision for uncollectible accounts as an operating expense rather than as a reduction in net patient service revenues in the consolidating statement of revenues and expenses.

PLANTE & MORAN, PLLC

October 7, 2005

Hurley Medical Center
Consolidating Balance Sheet
June 30, 2005
With Comparative Totals for June 30, 2004

Assets	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Current assets:			
Cash and cash equivalents	\$ 21,463,737	\$ 2,453,682	\$ -
Patient accounts receivable, net (Note 4)	69,192,051	326,661	-
Other receivables	4,862,197	566,568	(388,988)
Inventories	3,545,637	40,081	-
Prepaid expenses and other	2,247,145	1,341,537	-
Assets limited as to use (Note 5)	4,319,753	326,912	-
Total current assets	105,630,520	5,055,441	(388,988)
Assets limited as to use (Note 5):			
By the Board	49,911,728	326,912	-
Under bond indenture agreement - held by trustee	12,363,497	-	-
Restricted	369,340	-	-
Total assets limited as to use	62,644,565	326,912	-
Less assets limited as to use that are required for current liabilities	(4,319,753)	(326,912)	-
Noncurrent assets whose use is limited	58,324,812	-	-
Other assets:			
Deferred reimbursement and defeasance loss	1,022,042	-	-
Bond issuance costs, net	700,810	-	-
Investment in joint ventures (Note 14)	5,366,269	1,579,367	-
Investment in Hurley Heath Services	6,836,176	-	(6,836,176)
Other	-	59,430	-
Total other assets	13,925,297	1,638,797	(6,836,176)
Property, plant and equipment, net (Note 17)	59,271,985	1,557,032	-
	<u>\$ 237,152,614</u>	<u>\$ 8,251,270</u>	<u>\$ (7,225,164)</u>

Additional Schedules are not GAAP basis under GASB, but are for comparative purposes to hospital industry practices for not-for-profit health care providers.

	2005	2004
\$	23,917,419	\$ 33,158,440
	69,518,712	55,902,088
	5,039,777	7,900,397
	3,585,718	3,222,448
	3,588,682	3,130,259
	4,646,665	3,153,535
	<u>110,296,973</u>	<u>106,467,167</u>
	50,238,640	45,206,388
	12,363,497	17,342,320
	369,340	330,589
	<u>62,971,477</u>	<u>62,879,297</u>
	<u>(4,646,665)</u>	<u>(3,153,535)</u>
	<u>58,324,812</u>	<u>59,725,762</u>
	1,022,042	1,169,612
	700,810	773,391
	6,945,636	6,260,988
	-	-
	59,430	182,264
	<u>8,727,918</u>	<u>8,386,255</u>
	<u>60,829,017</u>	<u>61,880,196</u>
\$	<u>238,178,720</u>	\$ <u>236,459,380</u>

(continued)

Hurley Medical Center
Consolidating Balance Sheet (continued)
June 30, 2005
With Comparative Totals for June 30, 2004

	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Liabilities and Fund Net Assets			
Current liabilities:			
Accounts payable and taxes withheld	\$ 14,663,217	\$ 135,371	\$ (388,988)
Current portion of long-term debt and lease obligations (Notes 6 and 7)	3,630,789	-	-
Accrued expenses	20,737,316	1,279,723	-
Total current liabilities	39,031,322	1,415,094	(388,988)
 Accrued expenses (Note 13)	33,945,547	-	-
Lease obligations, net of current portion (Note 7)	2,979,013	-	-
Long-term debt, net of current portion (Note 6)	66,258,673	-	-
Total liabilities	142,214,555	1,415,094	(388,988)
 Fund net assets:			
Invested in capital assets, net of related debt	1,837,183	1,557,032	(1,557,032)
Unrestricted	89,971,216	5,279,144	(5,279,144)
Restricted	3,129,660	-	-
Total fund net assets	94,938,059	6,836,176	(6,836,176)
	<u>\$237,152,614</u>	<u>\$ 8,251,270</u>	<u>\$ (7,225,164)</u>

Additional Schedules are not GAAP basis under GASB, but are for comparative purposes to hospital industry practices for not-for-profit health care providers.

<u>2005</u>	<u>2004</u>
\$ 14,409,600	\$ 14,675,412
3,630,789	3,407,320
<u>22,017,039</u>	<u>27,518,425</u>
40,057,428	45,601,157
33,945,547	23,762,843
2,979,013	4,490,805
<u>66,258,673</u>	<u>68,131,939</u>
<u>143,240,661</u>	<u>141,986,744</u>
1,837,183	(603,770)
89,971,216	91,969,881
<u>3,129,660</u>	<u>3,106,525</u>
<u>94,938,059</u>	<u>94,472,636</u>
<u>\$ 238,178,720</u>	<u>\$ 236,459,380</u>

Hurley Medical Center
Consolidating Statement of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended June 30, 2005
With Comparative Totals for the Year Ended June 30, 2004

	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Operating revenues:			
Net patient service revenues	\$ 312,598,842	\$ 4,315,995	\$ -
Other operating revenues	24,216,879	17,055,893	(16,593,532)
Total operating revenues	336,815,721	21,371,888	(16,593,532)
Operating expenses:			
Salaries and wages	126,072,402	13,881,578	-
Professional services	30,523,309	81,259	(12,355,403)
Payroll taxes and fringes	46,699,433	2,610,760	-
Supplies	35,501,721		-
Purchased services and other	50,994,472	5,016,146	(841,687)
Depreciation and amortization expense	10,227,045	256,523	-
Interest expense	2,957,176	-	-
Provision for uncollectible accounts	34,970,385	-	-
Total operating expenses	337,945,943	21,846,266	(13,197,090)
Operating income (loss)	(1,130,222)	(474,378)	(3,396,442)
Non-operating revenues (expenses):			
Investment income and unrestricted donations	2,302,979	145,079	-
Management fees to PHO and joint venture income (expense)	(718,499)	-	3,396,442
Total non-operating revenues (expenses)	1,584,480	145,079	3,396,442
Excess (deficiency) of revenues over expenses before other activity	454,258	(329,299)	-
Other:			
Decrease in investment in Hurley Health Services	(329,299)	-	329,299
Assets released from restrictions for the purchase of capital assets	317,329	-	-
Total other	(11,970)	-	329,299
Excess (deficiency) of revenues over expenses before restricted fund activity and transfer of funds	442,288	(329,299)	329,299
Restricted fund activity and transfer of funds:			
Restricted gifts and bequests	1,647,519	-	-
Income and investments	45,205	-	-
Transfer of fund to general fund:			
Capital asset additions	(317,329)	-	-
Other operating revenue (expenses)	(1,352,260)	-	-
Increase in fund net assets	465,423	(329,299)	329,299
Fund net assets - beginning of year	94,472,636	7,165,475	(7,165,475)
Fund net assets - end of year	\$ 94,938,059	\$ 6,836,176	\$ (6,836,176)

Additional Schedules are not GAAP basis under GASB, but are for comparative purposes to hospital industry practices for not-for-profit health care providers.

2005	2004
\$ 316,914,837	\$ 293,637,252
24,679,240	27,171,090
341,594,077	320,808,342
139,953,980	136,547,021
18,249,165	20,031,877
49,310,193	36,008,815
35,501,721	36,215,070
55,168,931	49,476,273
10,483,568	11,279,371
2,957,176	4,969,907
34,970,385	26,964,785
346,595,119	321,493,119
(5,001,042)	(684,777)
2,448,058	954,706
2,677,943	2,098,517
5,126,001	3,053,223
124,959	2,368,446
-	-
317,329	960,873
317,329	960,873
442,288	3,329,319
1,647,519	1,424,991
45,205	43,467
(317,329)	(960,873)
(1,352,260)	(1,104,291)
465,423	2,732,613
94,472,636	91,740,023
\$ 94,938,059	\$ 94,472,636

October 7, 2005

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

Dear Board of Hospital Managers:

We have audited the financial statements of Hurley Medical Center (the Medical Center) for the year ended June 30, 2005, and have issued our report thereon dated October 7, 2005. During the audit, we had the opportunity to observe the Medical Center's procedures for financial reporting and the accounting system. In that process, we made a few observations that we feel should be communicated to you. We have also summarized some additional areas for Board consideration.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with the various personnel of the Medical Center, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This letter also summarizes the status of the comments and suggestions that have yet to be resolved from the June 30, 2002 through 2004 audits, and the status of all comments and suggestions from the June 30, 2005 audit.

Reimbursement Staff (June 30, 2002)

The reimbursement staff had two employees retire and has experienced other employee turnover in 2001 and 2002. The Medical Center had temporarily staffed the reimbursement department with several contractual employees and other positions remained open. It is critical that the Medical Center hire and retain permanent employees in this area due to the technical nature of the reimbursement function and the fact that a sense of history with the Medical Center is important with resolving ongoing audits and appeals.

June 30, 2003 status:

Management had begun the recruiting process to hire a permanent employee for the reimbursement department and had identified a viable prospect.

June 30, 2004 status:

Management was not able to hire the prospect identified in the prior year, and had not yet been able to find a qualified employee to fill this position but continued to recruit a permanent employee for the reimbursement department.

June 30, 2005 status:

Management has not yet been able to find a qualified employee to fill this position, but has been consulting on a regular basis with a experienced reimbursement manager who is physically on site at the Medical Center. Management will continue to look for an experience reimbursement staff.

Final Review of General Ledger Accounts (June 30, 2002)

As in the prior years, the closeout process did not allow for an independent review of the account balances by an immediate supervisor or allow the accountants to perform a final review of the general ledger balances to ensure that any last minute adjustments were properly considered. Based on the adjustments identified during the 2002 audit, there were number of balance sheet accounts that had adjustments posted to the accounts after the accountant had completed the year end analysis and reconciliation. We recommended that management allow for additional time for managers to review the general ledger accounts in comparison to the final audit schedules before the numbers are released to the finance committee. This final review process should improve the accuracy of the final close-out amounts and will ensure that all audit schedules are timely submitted.

June 30, 2003 status:

Procedures to review the general ledger before monthly statements are issued have been put in place. At the close of every month, a finance supervisor looks at the balance sheet to check that the balances in these accounts appear reasonable, also the managers review the expense accounts for reasonableness and make adjustments. During the closing process, managers also receive preliminary reports which they review for reasonableness before the numbers are finalized.

While reasonableness checks are done at month end, we believe there is still a need for a review of the general ledger accounts in comparison to the final audit schedules before the numbers are released to the finance committee.

June 30, 2004 status:

There is no change to this comment.

June 30, 2005 status:

The accountants have been able to review the general ledger accounts for last minute adjustments and this has improved the accuracy of the final audit schedules. Although all of the accounts are not reviewed by a manager, the significant accounts are being reviewed at the manager level. No financial information was released to the finance committee before the significant accounts were reviewed by the managers. The timeliness of the audit schedules still needs to be improved in order to complete the audit process sooner.

Contractual Allowances (February 28, 2003)

Several third party payers such as CMH, Health Plus of Michigan, and Health Plus Partners have multiple (six or seven) unsettled years. The general ledger tracked three elements of the third party payer process separately – charges, contractual allowances and payments. It was difficult to assess the settlement position of the Medical Center based on the different elements being recorded in different accounts and by having multiple years unsettled at any given time. This could result in the Medical Center having a significant settlement from a payer and management not realizing

the amount of the settlement. The settlement can impact future cash levels either negatively or positively. We recommended that management analyze the settlements accounts for all open years to determine the settlement amounts and that the open years be settled as soon as possible to enhance management's ability to manage the cash flow of the Medical Center.

We noted that the credit worthiness of The Wellness Plan (TWP) needed to be monitored.

June 30, 2003 status:

We noted during the 2003 audit that the CMH payer was current and that the Health Plus of Michigan and Health Plus Partners still had unsettled years from 1997 to present. In September 2003, management initiated communication with Health Plus Partners to resolve the outstanding years.

The Wellness Plan was in bankruptcy and had been taken over by the state. The state indicated that the Office of Financial and Insurance Services would pay provider claims for services provided on or after July 1, 2003. Reimbursement for services with date of service prior to July 1, 2003 would be determined by the Office of Financial and Insurance Service after reviewing The Wellness Plan's financial condition. The Medical Center had booked a reserve on this settlement of 50% of the outstanding settlements. There had been negotiations between the state and a potential buyer for TWP. Management has monitored this issue closely and estimated for a potential loss as appropriate.

June 30, 2004 status:

As of the 2004 audit, Health Plus of Michigan and Health Plus Partners still had unsettled years from 1997 to present.

During 2004, The Wellness Plan members in Genesee County area were sold to McLaren Health Plan. Since the sale, The Wellness Plan had been paying current claims. Management has received correspondence from The Wellness Plan that old outstanding claims would also be paid at Medicaid rates. In light of this, the Medical Center reduced the amount recorded for the impairment loss at June 30, 2004 to 10% of what was recorded for the impairment loss at June 30, 2003.

June 30, 2005 status:

As of the 2005 audit, Health Plus of Michigan and Health Plus Partners still have unsettled years from 1997 to present. The estimated Health Plus Partners net settlement receivable of \$8 million may not be fully realized and reserves have been allocated to this potential exposure.

Bank Reconciliations (February 28, 2003)

It was noted during the interim review at January 31, 2003, that the monthly interim financial statements included a reclassification journal entry of the cash balance based on the bank balance at month end and a calculated outstanding check amount. Upon further investigation, it was noted that the bank reconciliation was not being completed monthly, rather only at year end. The monthly procedures included the preparation of an outstanding check listing; however the depository account was not reconciled to the general ledger account and the payroll activity was not reviewed monthly.

Strong internal accounting controls include monthly bank reconciliations to ensure the accuracy of the ending balances. Furthermore, by reviewing the bank reconciliation monthly, the task would not be as significant for the year end close which should improve staff efficiencies.

June 30, 2003 status:

We noted that monthly bank reconciliations were still not being performed in detail as noted above. This responsibility is currently assigned to the reimbursement staff which had been short two full time people for almost a year. Management needed to evaluate whether it is appropriate to assign responsibility to the reimbursement staff and what the appropriate time table is to complete the assignment (i.e. before the interim financial statements are issued or by month end.)

June 30, 2004 status:

Although bank reconciliations are not being completed regularly by employees in the reimbursement department, the reconciliations are generally being done three or four months after the close of the month being reconciled. Management was currently working on completing the reconciliation prior to the issuance of the interim financial statements.

June 30, 2005 status:

Management has implemented reconciliation procedures that identify significant variances before the monthly statements are completed. The majority of these steps are completed monthly however, the final reconciliation is completed as schedules permit. Because the reconciliations are prepared by the reimbursement department, during the cost report preparation period, the delay in the final reconciliation steps may result in a three to four month lag. Management continues to work toward a goal of having all bank reconciliations completed within a one month lag. This improvement is contingent upon the restructuring of the department and the additional of an additional staff person to absorb certain accounting responsibilities.

Computer File Management (February 28, 2003)

During our audit, comments about the computer files were noted as follows:

- Currently files are saved under the user directory; therefore the author of the file must be known to be efficiently located
- Some files are saved in several different directories rather than being effectively indexed and referenced with file name footers
- Some staff members save to the hard drive or diskettes instead of the network

These comments indicate that computer files are not handled consistently and that the structure may not be efficient. We recommended that a departmental wide directory structure be developed for the shared network drive and that existing files be converted to this new format. There should also be a file management policy developed for employees to help guide employees when saving files to the network directory. This will make the saved files universal and easier to find by new employees or other employees needing to retrieve a file prepared by another associate.

June 30, 2003 status:

There is no change to this comment.

June 30, 2004 status:

The current focus of resolving this issue had been to get finance employees all on the same server. This was accomplished during the fiscal year and now the focus will be having employees begin to save their documents with a prescribed format to the network directory. Areas, such as reimbursement had already begun saving their files to the network directory.

June 30, 2005 status:

A new network directory has been established for the finance employees. It is currently being used to store all year-end audit schedules related to the closing of fiscal year 2005. This comment has been completely resolved.

Accounts Receivable (February 28, 2003)

During review of accounts receivable, it was discovered there were significant credit balances within the accounts receivable aging systems. Based on inquiry it was noted that only the Medicare credit balances are reviewed on a regular basis due to a compliance requirement. A sample of the credit balances were reviewed which resulted in a significant audit adjustment. Without an effective accounts receivable credit balance policy, the financial statement could be misstated by improperly netting liabilities with the accounts receivable whereby understating the assets and liabilities, which correspondingly impacts the bad debt allowance and contractual allowance calculations.

We recommended the Medical Center establish a policy on handling credit balances within the aging systems of accounts receivable for both the main accounts receivable system (SMS) and the physician billing system (POLCI). A regular review either quarterly or semi-annually will identify the credit amounts and these amounts can be properly reclassified as a liability or identify issues with contractual posting errors.

June 30, 2003 status:

Management researched the credit balances within accounts receivable and, as a result, the overall net credit balances have decreased approximately \$2.5 million between April 30th and June 30th. A total of \$7.5 million of credit balances remain. We believed it would be beneficial to establish a formal policy that is communicated to the staff to establish procedures and set expectations regarding this issue relative to 1) a timetable for the clean up of the old balances and 2) any new balances that are created in the future.

June 30, 2004 status:

During 2004, management implemented a formal credit balance policy on currently occurring credit balances for Inpatient and Outpatient receivables. The policy is that when a credit balance is generated, it is identified and procedures for resolution are begun the next working day. The credit balances generated prior to the June 30, 2004 fiscal year are still an issue that needs to be resolved in the Inpatient, Outpatient, and Physician Billing areas.

June 30, 2005 status:

At June 30, 2005, the prior year credit balances on the SMS accounts receivable system had continued to decline to \$4.8 million and the current year credit balances are being researched and resolved on a regular basis. The credit balances on the physician billing remained relatively constant with the prior year. The credit balances were properly considered during the closeout process as the financial information was generated.

Internal Financial Statement Process (February 28, 2003)

During the financial statement write-up process three items were noted as follows:

- The current MSA financial summary reports (GL-F-1A and GL-F-1B) do not balance. The variance relates to the fund balance accounts not considering the current profit.
- The current monthly income when added to the prior month year to date income does not tie to the current year to date income. These variances have been adjusted to the balance sheet through the retention account of approximately \$150,000.
- The new balance sheet accounts are not pointed to a financial statement line item and are manually adjusted every month. After the year end the balance sheet accounts are properly pointed to a specific financial statement line item.

We recommended that the information systems department review the MSA roll-up accounts and consult with the Finance department to ensure that all revenue and expense accounts were properly pointed to a financial statement line and investigate the variance. We also recommended when new accounts were added a financial statement line item is assigned.

June 30, 2004 and 2003 status:

There is no change to this comment.

June 30, 2005 status:

Currently the internal financial statement reports balance on a monthly basis and all balance sheet accounts that are not pointed are assigned to a financial statement line on a monthly basis so they do not carry forward from month to month. This comment has been completely resolved.

Interim Budgets (February 28, 2003)

During interim procedures at January 31, 2003, it was noted that the Medical Center's revenue and contractual allowance model is not updated on an interim basis. The model considers several reimbursement variables such as census, case mix, payer mix and current reimbursement rates. We recommended that this model be updated two to three times a year to consider the impact the reimbursement variables have on the Medical Centers net patient service revenue. This information can be considered with the actual expenditures to assist management with operational decisions.

June 30, 2003 status:

Management had not implemented this recommendation due to the timing of the completion of the February audit and the June close out taking place within a short time period. Management intended on evaluating this matter in the fall of 2003.

June 30, 2004 status:

Management was still only updating the contractual allowance model annually, but has a goal of beginning to update the model on a quarterly basis beginning in fiscal year 2005.

June 30, 2005 status:

Management has questioned whether the interim budget software is the most efficient tool to monitor the current year contractual allowance estimates. The interim budget model remains the same as it has in the past, being updated annually. During the 2005 audit, management requested that Plante & Moran reimbursement specialists evaluate contractual allowances and settlement positions on an interim basis during fiscal year 2006.

Malpractice Insurance (June 30, 2004):

The malpractice excess coverage insurance carrier had changed twice over the past three years. The carrier changed as of July 1, 2002 because the existing carrier no longer offered malpractice excess insurance policies. At that time no tail coverage was purchased because it was not economically prudent. This meant that cases in which the incident occurred prior to July 1, 2002 and were not reported until after July 1, 2002 were not covered by a malpractice insurance policy. The carrier was changed again as of July 1, 2004. When the carrier was changed effective July 1, 2004, tail coverage was purchased to cover claims retroactive back to July 1, 2002 (the maximum coverage available to the Medical Center). There are many malpractice cases for which no excess coverage exists. The cases are in various stages of the settlement or litigation process. The current accrual for malpractice claims was based on the combined actuarial estimate of "incurred but not reported" claims plus an estimate of the liability for the existing claims that an unfavorable outcome was "probable" per the Medical Center's legal counsel. The actual results of those claims could differ from estimates and could possibly have a significant liability that the Medical Center would have to fund "out of pocket".

We recommended that legal counsel and management continue to monitor the trends and results of the cases with no insurance coverage to determine if accrued liabilities are adequate.

June 30, 2005 status:

As in prior years, management has engaged the services of an independent actuary to perform a valuation of potential liability for malpractice. This valuation was performed as of June 30, 2005, based on the known cases through that date, where as in prior years, valuations had a one year lag in known cases. The June 30, 2005 actuarial valuation was utilized by management to record the estimated liability for both known cases and incurred but not reported incidents. This approach is a more conservative one than historically has been utilized and we encourage continued use in the future. Based upon the significance of exposure in this area, we recommend that self-insured hospital give consideration to having the valuation performed at an interim date (six or nine months into the fiscal year) in order to avoid surprises and more accurately reflect estimated liability. A decision whether to have such a valuation performed should be evaluated on a cost/benefit basis.

Outstanding Medicare Settlements

Medicare had several outstanding settlement years extending as far back as fiscal year 1993. We recommended that the Medical Center continue efforts to resolve these old settlement years with United Governmental Services (UGS) as soon as possible so they can be closed on the Medical Center's books. Having multiple old outstanding settlements leaves UGS free to revisit issues that had been previously resolved and increases the probability that new staff from either the Medical Center or UGS will be introduced who are not familiar with the issues in the unsettled years.

June 30, 2005 status:

Management has engaged the services of a reimbursement consultant who formerly was a senior executive at UGS. The Medical Center is in the process of discussing and negotiating older settlements/appeals which aggregate on the balance sheet approximately \$2.7 million as of June 30, 2005. We encourage management to monitor the status closely and continuously evaluate realization of these projected receivables.

June 30, 2005 Observations, Comments, and Recommendations:

Impact of New GASB Regarding Retiree Health Care Liabilities

The Governmental Accounting Standards Board issued a new pronouncement, GASB Statement No. 45, "*Accounting and Financial Reporting by Employees for Post-employment Benefits Other Than Pensions*" that will require governmental entities to reflect the estimated liability for retiree health care costs (that is not funded through a pension trust) on the balance sheet of the governmental unit. The liability is required to be actuarially calculated and to cover the estimated cost of the benefit over a period approximating the employees' years of service. Currently, the Medical Center pays for a portion or all of retiree health care premiums for various retiree groups. Generally, this liability is paid for on a pay-as-you-go basis and the new pronouncement will require the estimated future costs to be accrued currently. The pronouncement is effective for the Medical Center for fiscal years beginning after December 15, 2006. While the implementation is a few years away we want to make the management and the Board aware of this accounting standard so that preparations can be made to implement the standard and to prepare for its impact.

Bad Debt Allowance Factors

The Medical Center continues to utilize factors in estimates bad debt allowances that were developed during a study completed in 2000. We would encourage management to perform a retrospective look-back analysis of actual accounts written off as compared to the respective allowance. We would also encourage management to consider updating the factors for more recent history.

Hurley Health Services

Hurley Health Services (HHS) is a wholly owned subsidiary of the Medical Center is reported as a component unit for basic financial statement reporting. HHS has a 50 percent interest in the joint venture Hurley/Binson's Medical Equipment, Inc. (H-Care). In order for HHS to report its prorata share of the net income/loss of H-Care, audited financial statements of H-Care are required. We were advised of financial concerns involving the valuation of receivables at H-Care which delayed the finalizing of the HHS audit, which impacts the ultimate reporting of Hurley Medical Center financial reports. We encourage management to monitor this situation. Due to new accounting pronouncements that will be effective for the Medical Center's fiscal year 2006, HHS will be required to consolidate the financial information of H-Care into its financial statements in accordance with Financial Interpretation 46 (FIN 46), Consolidation of Variable Interest Entities.

Thank you for the opportunity to be of service to Hurley Medical Center. Should you wish to discuss any of the items included in this report, we would be happy to do so.

Very truly yours,

PLANTE & MORAN, PLLC

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